

Chapter 6

Russia

Russia faced many challenges in the year to mid 2009. After a decade of uninterrupted economic growth, it was severely affected by the world financial crisis and the decline in global energy prices. The first half of 2009 saw an extraordinary double-digit contraction in GDP and the return of a large budget deficit. Meanwhile, the August 2008 war in Georgia delivered a major blow to relations between Russia and the West, stalling Russia–NATO cooperation and alarming some of Russia’s neighbours. Moreover, a dispute between Russia and Ukraine over natural-gas prices, which resulted in an interruption of supplies to many European countries in January 2009, prompted Europe to pay more attention to ensuring future energy security.

As President Dmitry Medvedev marked, in March 2009, the first anniversary of his election to the presidency, the Russian political elite continued to view his predecessor, Prime Minister Vladimir Putin, as the real political leader and strategic decision-maker. Medvedev, Putin’s chosen successor, remained loyal to his predecessor, although some differences emerged in their outlook on both domestic and foreign-policy issues.

The sudden decline in the economy exposed a number of vulnerabilities. Partly because of Putin’s reluctance to embrace economic reforms, Russia had remained highly dependent on revenues from gas and oil, and control of the economy was heavily centralised. The crisis enhanced the position of economic reformers within the government, although they faced strong opposition from those who favoured authoritarian control – and the latter seemed to be strengthened as the state bailed out prominent businessmen who ran into financial problems. Over time, however, the economic troubles seemed likely to throw into question the sustainability of the implicit social

contract under which the Russian population – including a nascent middle class hit particularly badly by the crisis – sacrificed political freedoms in exchange for the state’s promise to deliver an ever-improving quality of life for its citizens. Protests resulting from the crisis were isolated, but the political outlook for 2012, when Medvedev’s presidential term expires, began to look uncertain.

A period of strain in US–Russian relations was not helped by the crisis in Georgia, which saw US Navy ships enter the Black Sea to deliver aid to Georgian ports, and the US Air Force fly in aid – though Georgian hopes for more extensive American intervention were frustrated. Moscow had long viewed with alarm the expansion of NATO into a region it saw as its own sphere of influence, and was particularly concerned at George W. Bush’s strong support for NATO membership for Georgia and Ukraine. American plans to locate missile interceptors and missile-defence radars in eastern Europe added to Russian fears of encirclement. Hence, despite weeks of mutual provocation (including exchanges of fire between Georgian and South Ossetian forces, as well as almost simultaneous US–Georgian and Russian military exercises), Georgia’s 7 August move on the South Ossetian capital of Tskhinvali, during which Russian peacekeepers came under attack, was treated in the Russian media as the equivalent of the 11 September 2001 attacks on the United States. After a brief period of combat, Moscow ignored repeated Western calls to pull its intervening troops out of Georgia. Russia paid a high diplomatic price for its hasty recognition of Abkhazia and South Ossetia as independent states following the intervention. Only Nicaragua followed Moscow’s lead, leaving it isolated.

Tensions over the August war resulted in a temporary suspension of relations with NATO and a delay in negotiations over a strategic treaty with the EU. A window of opportunity, however, was opened by the change of US administration. Newly elected President Barack Obama showed a personal commitment to improving relations with Russia, and his vice president, Joe Biden, said at the Munich Security Conference in February 2009 that Washington wished to ‘press the reset button’ on US–Russian relations. Following a brief meeting between Obama and Medvedev in April 2009 at the G20 London summit, the two countries began intense negotiations to upgrade relations, and particularly on renewing the Strategic Arms Reduction Treaty (START) which was to expire in December 2009. Obama’s visit to Moscow on 6–7 July produced progress on arms control and US military transit through Russia to Afghanistan, but not on US missile defence in

eastern Europe or NATO enlargement. Questions remained as to Russia's willingness – and Medvedev's ability – to achieve a major breakthrough with the United States. Important figures in Russia continued to mistrust the United States and saw no value in seeking strategic rapprochement.

Russia, meanwhile, sought to expand its room for manoeuvre in both West and East. It hosted summits of the Shanghai Cooperation Organisation (SCO) and the BRIC (Brazil, Russia, India and China) group of emerging economic powers. Medvedev travelled to Latin America, Africa and the Middle East and offered loans to several Central Asian countries. Overall, despite the shift in Russia's economic fortunes, there was little change in the assertive and ambitious tenor of its foreign policy, seeking to drive tough bargains with the West and to assert its influence in post-Soviet Eurasia.

Reversal of fortunes

The impact of the global financial crisis was severe, and took the country's leadership by surprise. In March 2008, when Medvedev was elected president, Russia's remarkable economic revival was both the foundation of Putin's legacy and a guarantee of his continued political power. In the eight years of Putin's presidency, Russia enjoyed robust growth of around 7% annually, accumulated very large foreign-exchange reserves and ran large budget surpluses. Foreign investment grew sharply; the rouble became a stable currency, steadily appreciating against the dollar; and the population enjoyed a remarkable rise in living standards. Russia's economic growth fuelled its foreign-policy ambitions and assertiveness.

By May 2009, however, Russia's economic fortunes – like those of many other emerging economies – had turned upside down. Following the fall in oil prices and amid global recession, the Russian economy contracted by 10.2% over the first five months of 2009. Although the government spent heavily to prop up the rouble, the currency declined by 35% against the dollar between July 2008 and April 2009. The Russian stock market at one point had lost over 75% of its value, but later recovered slightly; in May 2009 it stood at around half its May 2008 value. In the year to May 2009 industrial production declined by over 17%, and the Ministry of Economy estimated that in January–April 39% of all industrial enterprises were making losses.

Like other emerging markets, Russia experienced a major outflow of foreign capital, which started in August 2008 during the war with Georgia and continued at least to mid 2009. In 2008 net capital outflow was estimated at around \$130 billion, although it had slowed considerably by mid 2009.

In the first quarter of 2009 foreign investment was down over 30%. Foreign trade contracted sharply, with May 2009 exports down 45% year-on-year and imports down 44.6%. Russia had a budget deficit for the first time in many years, expected to exceed 7% of GDP in 2009. For the time being Russia could cover this deficit from its reserves and the returns on its investments. However, if the economy continued to contract and oil prices remained at around \$60 per barrel, reserves could become severely depleted. The economy remained overwhelmingly dependent on the export of oil, gas and other commodities, the prices of all of which were well below their 2008 peaks.

The government was slow to react. For months Putin and Medvedev argued that it was not Russia's crisis, and that Russia would remain an

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island of stability amidst a Western, and particularly American, economic collapse. But as the effects began to reverberate through the Russian economy – the decline in oil prices, the outflow of foreign capital, the fall in the Russian stock market and growing pressure on major Russian private companies to pay off large foreign debts – the leadership shifted from denial to anger, portraying the crisis as a deliberate tool used by the United States to halt Russia's rise.

Eventually reality sank in, and Medvedev was compelled to admit that the crisis had specific Russian characteristics and was partly a result of Moscow's own policies.

The delay meant that only emergency measures could be taken, including bailing out industrial oligarchs who faced default, increasing financial support for state-owned enterprises and spending a large part of the country's reserves to slow down the depreciation of the rouble. No major economic stimulus funds were allocated until the economy was in deep recession.

In January 2009 the first signs emerged of friction between Medvedev and Putin, who as prime minister was primarily responsible for dealing with the crisis. Medvedev criticised government policies on several occasions as too slow and ineffective. He dismissed some officials and governors and stepped up an anti-corruption campaign. Putin, however, remained firmly in charge as head of the United Russia Party, which dominated the parliament, and through the support of a loyal political and business elite and regional leaders, as well as popular backing.

The financial crisis increased the influence of the technocrats (often referred to as liberals in contrast to the authoritarian *siloviki*, officials who

came from the security services). Technocrats such as Finance Minister Alexei Kudrin and First Deputy Prime Minister Igor Shuvalov were outspoken, warning that conditions would remain difficult and that a rapid recovery in oil and gas prices should not be expected. They argued that Russia should use this window of opportunity to restructure the economy away from its dependence on commodities. They were sceptical about the value of propping up the rouble, and argued against putting more funds into state-owned conglomerates.

By mid 2009 Russia had developed a more sophisticated policy response, which included funds to support the banking system, high-tech companies and investment in infrastructure; cuts in oil-export duties and corporate and personal taxes; and provision of greater social support, including unemployment benefits, pensions and re-training. The unemployment rate reached 10% in March and the World Bank forecast that it would reach 13% in 2009, the highest level since Putin became president in 2000. Many people, moreover, were subject to salary cuts or shorter work weeks, and the volume of overdue wages increased sharply. Towns built during the Soviet era around a single major industrial plant were particularly badly hit: labour mobility remained very limited, partly because of Russia's vast distances and varied climate. The World Bank predicted that 17% of the population would be below the poverty level in 2009, an increase of 4.8 percentage points from 2008.

Although the Russian political elite expressed concern about the possibility of social unrest, the political impact of the crisis was muted. There were a number of protests, but these did not escalate into sustained action against the government. Police in Vladivostok used force to suppress demonstrations against the introduction of import duty on foreign cars. But when large enterprises halted work in Pikalevo, southeast of St Petersburg, and people blocked the major east-west highway, Putin paid a visit and insisted on television that Oleg Deripaska, once one of Russia's richest tycoons, should restart production and pay arrears. Deripaska, who was only holding on to his assets thanks to a state bailout, had no choice but to comply.

Although protests were not widespread, public attitudes were changing. Opinion polls showed that fewer people were confident that the country was 'on the right track'. An authoritative poll conducted by Levada-Center in May 2009 showed that 29% of respondents were confident that the government would be able to improve the situation in the near future, down from 37% a year before. The same poll showed a decline in Medvedev's approval

rating from 63% to 58% in the first five months of 2009. In addition, 81% believed he was simply continuing Putin's policies, and only 2% thought he was implementing new policies.

These attitudes seemed to accurately reflect the balance of political power between Putin and Medvedev. It appeared that Medvedev had decided not use the opportunity presented by the economic crisis to launch a bid for real power by relying on members of the Russian middle class dislocated by Putin's emergency measures. With a weak domestic power base, Medvedev focused primarily on foreign policy, where his ability to promote change was hampered by geopolitical uncertainties generated by the crisis and by the lengthy transition between the George W. Bush and Obama administrations. While Medvedev occasionally criticised Putin's decisions and pushed for political changes, he did not offer a significantly different strategy. On those occasions when Medvedev and technocrats in the government sought to advance their agenda – for example, on Russian accession to the World Trade Organisation (WTO) – Putin was able to effectively and directly assert his power and in most cases to prevail. His decision to put forward a common bid for WTO membership with Kazakhstan and Belarus, members of the Eurasian customs union, which only existed on paper, was unlikely to be accepted and was likely only to delay Russian entry, which was backed by the Obama administration and the EU.

By mid 2009 a moderate increase in oil prices, which stood at over \$65 per barrel in June 2009, relieved pressure for reforms and provided resources that could be used to quell public discontent. It therefore appeared unlikely that the financial crisis would serve as a springboard for political and economic change. Meanwhile, Medvedev's willingness and ability to challenge Putin and to construct an independent power base remained in doubt.

The August war

In August 2008, Russian and Georgian forces fought a five-day war. Moscow justified its deployment of troops as a response to an attack by Georgia on its breakaway region of South Ossetia. Although the actual fighting was limited and Russia easily defeated the Georgian forces, the conflict sent shock waves through Europe and post-Soviet Eurasia. Russia's show of force in Georgia, the first open and properly organised use of its military against a neighbouring state in the post-Soviet period, sent a signal not only to the West (which had failed to reach consensus at the Bucharest NATO summit in April 2008 regarding NATO membership for Georgia), but also

to other neighbours seeking to join NATO and the EU. Russia demonstrated its resolve to defend its interests in Eurasia. Medvedev's signature on 26 August of a decree recognising South Ossetia and Abkhazia, the other break-away region, as independent states was a further show of defiance against Western criticism.

The war's origins went back to the end of the Soviet Union and the emergence of an independent Republic of Georgia dominated by ethnic Georgians and involved in conflicts with two ethnic minorities, Ossetians and Abkhazians. Both previously had their own autonomous regions within Soviet Georgia, and sought greater autonomy and eventually independence from the newly established republic. Conflict in South Ossetia took place in 1991–92, and in Abkhazia from 1992 to 1993. In both cases Georgia initiated military activity and Russia provided support – both organised and in the form of volunteers from the North Caucasus – to the breakaway territories. These conflicts remained unresolved, and South Ossetia and Abkhazia both functioned as self-proclaimed and de facto independent states outside Georgia's control. Georgian President Mikheil Saakashvili came to power in 2004 vowing to re-establish the republic's territorial integrity. After his unilateral offers of autonomy to Abkhazians and South Ossetians failed to win their support, Saakashvili began to prepare for a military solution, while at the same time pursuing closer ties with the United States, which supported NATO membership for Georgia. Bush supported Georgia as a success story for his democracy-promotion agenda. However, a number of European states grew concerned over Saakashvili's increasing recklessness, and Germany and France blocked the US push to advance Georgia's membership process at the April 2008 NATO summit in Bucharest.

Russia viewed Georgian support for 'colour revolutions' in Eurasia and its striving for NATO membership as a direct security threat, and had imposed economic sanctions on Georgia. Moscow had already issued Russian passports to the majority of residents of Abkhazia and South Ossetia, anticipating that it would only be a matter of time before Saakashvili decided to use force rather than accepting that both regions were lost.

After several weeks of escalating violence in and around Abkhazia and South Ossetia, which some suspected Russia of provoking, Georgian troops moved into South Ossetia on 7 August and began a massive and indiscriminate bombardment of its capital Tskhinvali. Russia reacted swiftly, as its troops were already in position on the other side of the Caucasus following large-scale military exercises just a few days prior to the Georgian attack. Russia

moved its tanks and troops into South Ossetia on 8 August, and defeated the Georgian troops, which withdrew on 10 August. Simultaneously, Russian troops moved into Abkhazia, and later took positions beyond Abkhazia and South Ossetia in Georgia proper, where they established a large security zone, and bombed and damaged Georgian military installations across the country. The Russian advance stopped some 50km short of the Georgian capital Tbilisi.

The war formally ended on 12 August when President Nicolas Sarkozy of France, which held the rotating EU presidency, mediated a ceasefire on the basis of a six-point plan which called on both sides to stop hostilities, move

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troops to pre-7 August positions and allow access for humanitarian organisations to the areas with affected populations or internally displaced persons. Russia defied mounting Western criticism that Russia’s use of force, involving taking up positions well inside Georgia proper, was disproportionate. After agreeing to an EU monitoring mission, Russia took two months to withdraw from Georgia proper, meeting a 10 October deadline. However, Russian troops stayed in both Abkhazia and South Ossetia, where

they established military bases on the basis of treaties agreed after Russia recognised the two territories as independent states. Russia also vowed to guard their borders with Georgia and pledged substantial funds to support economic reconstruction.

Thus Russia won the war, but paid a high political and diplomatic price; its relations with the United States and Europe hit their lowest point since the end of the Cold War. Russia–NATO and Russia–EU relations were briefly suspended and countries that had once been part of the Soviet Union openly demonstrated they would not back Moscow on issues where their interests were at stake, no matter how much pressure was applied. The war occurred against the backdrop of the mounting international credit crisis, and investors started to pull money out of the Russian market, heightening the impact of the global crisis on the Russian economy.

A year after the conflict, however, the strategic cost seemed to have diminished. Russia had established a political and military presence in Abkhazia and South Ossetia which it had no intention of surrendering. Relations with the EU and NATO were re-established, although mutual trust remained a problem. Russia–US relations improved following the election of Obama,

who abandoned, for the time being, the promotion of NATO membership for Georgia and Ukraine. Russia's relations with other former Soviet states, which had refused to recognise the separatist regions, were normalised as Moscow used chequebook diplomacy to bail out its neighbours during the financial crisis. However, Russia's recognition of Abkhazia and South Ossetia remained a source of friction with the United States and Europe.

For Georgia the price of its August gamble in South Ossetia was much higher. It effectively lost any chance to integrate Abkhazia and South Ossetia into Georgia on its own terms; or even to hope for a settlement short of full integration. It failed in its goal of internationalising the issue. Russia established bases in Abkhazia and South Ossetia and blocked the extension of UN and OSCE missions in these territories. Moreover, domestic political instability in Georgia increased as Saakashvili's political opposition called for his resignation and persistently staged protest rallies. Once it became clear that Georgia had started the war, even if under provocation, Saakashvili lost support and credibility in the West. Georgian–Russian relations were broken, with Moscow insisting that normalisation was not possible without a change of government in Tbilisi.

Other reputations were battered by the August conflict. The Bush administration was viewed as bearing some responsibility through its strong support for Saakashvili, its failure to restrain his belligerence and its strategic mistake of putting a Membership Action Plan for Georgia on the agenda of the Bucharest Summit without ensuring that the idea enjoyed the full support of NATO allies. The OSCE, which was responsible for promoting the Georgia–South Ossetia peace process and had a monitoring mission deployed in South Ossetia, failed to prevent and contain the conflict due to disagreements among its members – which include both Georgia and Russia. Russia later blocked the extension of the OSCE mandate establishing separate missions to Georgia and South Ossetia, which closed on 30 June 2009.

The UN Observer Mission in Georgia, deployed for over 16 years and operating on both sides of the administrative border line in Abkhazia and Georgia proper, met a similar fate when Russia vetoed a UN Security Council resolution proposed by the United States and Britain to extend the mission. Moscow demanded that separate missions be established in Georgia and Abkhazia and that there be no explicit reference to Georgia's territorial integrity. The mission was thus effectively closed down on 16 June 2009 and was to be fully withdrawn within three months. The UN had been operating in the Gali region of Abkhazia, home to thousands of ethnic Georgians

who returned to live in Abkhazia over a decade ago and whose security was potentially at risk as Abkhazian forces and Russian border guards moved in without external monitoring. The UN mission had also played an important role in facilitating communication between Georgia and Abkhazia, with regular helicopter flights which could bring in international officials and experts. With the mission's closure and Georgia's refusal to allow foreign diplomats and humanitarian organisations to enter Abkhazia, travel into the Abkhazian capital Sukhumi became extremely difficult. Moreover, UN reports on the Georgia–Abkhazia conflict, regularly issued on the basis of monitors' reports, had provided impartial and accurate information on

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developments for both sides in the conflict, as well as for the international community. These independent assessments were no longer available.

The EU, through France, played an important role in ending the August war. Under the terms of the ceasefire brokered by Sarkozy, the EU deployed a 200-strong unarmed civilian EU Monitoring Mission (EUMM) to Georgia. Its main tasks included monitoring and analysing the situation, including compliance with the six-point agreement; monitor-

ing and analysing the return of internally displaced persons and refugees; and contributing to the reduction of tensions through liaison, facilitation of contacts between parties and other confidence-building measures.

Since the EU did not recognise the independence of Abkhazia and South Ossetia, and treated them as part of Georgia, the monitoring mission made several attempts to negotiate permission to operate in Abkhazia and in South Ossetia. Russia was reluctant to accept the EUMM's mandate in the breakaway republics, and both refused it permission to enter. The EUMM thus operated only on the Georgian side of the boundary. Moscow's interpretation of the agreement brokered by Sarkozy was that the EU now guaranteed that Georgia would not start another war. Russia and South Ossetia regularly claimed that Georgian troops were being concentrated on the border with South Ossetia, although the EUMM found no evidence substantiating these claims. Unless renewed, the EUMM mandate was to expire in September 2009, and there were differences within the Union regarding the mission. Some believed that it should continue as a symbol of the EU's growing role in the region, even if it was only able to operate on one side of the border. Others argued that the EU mission had been deployed in conjunction with

the long-standing OSCE and UN missions and, as the latter were closing down, the EUMM could not be left to operate alone. Moreover, the EUMM's mandate did not provide for long-term deployment. Even if the EUMM mandate were extended beyond September 2009, there would be a smaller chance that it would be extended again in 2010.

The EU was also involved in facilitating an informal dialogue in Geneva between the parties to the conflict and international actors. The EU's special representative for the crisis in Georgia, French diplomat Pierre Morel, led the discussions, along with co-chairs representing the UN and OSCE. Although there were initial difficulties in resolving status questions surrounding potential participants, several rounds of meetings took place and a 'status-neutral' format was established. However, with the exception of an informal agreement on a (yet to be implemented) incident-prevention mechanism, as of mid 2009 the talks had not produced any practical results. The future of the Geneva discussions was also in question after the OSCE and UN mandates in Georgia ended. Russia expressed reservations about turning them into permanent negotiations.

The prospects for the two breakaway territories were also uncertain. South Ossetia had been less keen to pursue real independence than to be integrated with the Russian Republic of North Ossetia, where the majority of Ossetians live. But Abkhazia had always sought independence from both Georgia and Russia. Although the majority of Abkhazians welcomed the presence of Russian troops and felt secure for the first time in 16 years, the end of the UN mission was a major blow to those who feared being swallowed by Russia, especially in light of the 2014 Winter Olympics in Sochi, a few kilometres from the border. Russia announced that it intended to pursue Olympic construction and infrastructure projects in Abkhazia and that it planned to open a naval base at Ochamchire in Abkhazia for part of its Black Sea fleet currently based at Sevastopol, Ukraine. Russia planned to keep around 1,700 troops in Abkhazia and to deploy border guards on the Abkhazia–Georgia border.

Resetting US–Russian relations

Given the legacy of mistrust during the Bush administration, Russian officials did not rush to embrace the wish expressed by new US Vice President Joe Biden at the Munich Security Conference in February 2009 to 'press the reset button' in relations with Russia. But at the G20 summit in London in April 2009, Medvedev and Obama agreed to negotiate substantial cuts in

strategic nuclear weapons and to reflect these in a successor to START. They also pledged to cooperate on issues from Afghanistan to non-proliferation and the Middle East peace process. And Washington and Moscow cooperated on preparing a UN resolution condemning North Korea's May 2009 nuclear test.

On 6–7 July Obama travelled to Moscow for what was a major test of the ability of the United States and Russia to translate good intentions into practical agreements and compromises. Although the visit did not produce any breakthroughs and reflected continuing reservations on both sides, important agreements were reached. Moscow agreed to allow US military supplies for Afghanistan to transit its territory, with up to 4,500 flights per year, saving the US government \$133m annually and enabling it to rely less on transit through Pakistan. Moscow had already signed similar accords with Germany, France and most recently Spain. Russia also agreed to cooperate with the United States on training the Afghan army and police and to participate in economic-development efforts in Afghanistan. In return, the United States agreed to step up cooperation on fighting poppy cultivation and drug trafficking from Afghanistan, a major problem for Russia.

The United States and Russia agreed to establish a bilateral commission co-chaired by Obama and Medvedev but coordinated by US Secretary of State Hillary Clinton and Russian Foreign Minister Sergei Lavrov. The commission consisted of 13 working groups covering topics as varied as security, education, business and civil society. The idea was to establish a strong inter-agency network to support US–Russian relations.

Despite such progress, the area where the summit promised most produced disappointing results. The two sides failed to agree ambitious new cuts in strategic nuclear weapons, settling on a target range for a START replacement agreement of 1,500–1,675 warheads on each side by 2017, only a minor advance on the Moscow Agreement signed by Bush and Putin calling for 1,700 by 2012. The range for delivery systems remained quite large at 500–1,100. Lavrov said a significant reduction of delivery systems would be a Russian priority, but Washington was less keen because it was considering converting some of the systems to conventional payloads. For Russia a direct link between reduction of offensive weapons and missile defences was a priority, but the United States made no commitment to abandon its plans for missile defences in Europe. The differences reflected the scale of challenges faced by negotiators on both sides as they try to produce a new START agreement before the end of the year.

The tone of the summit was perhaps its most striking feature. Obama refrained from criticising Russia's domestic political system and only briefly raised US–Russian differences on Georgia. However, much more time and concrete steps looked to be needed to rebuild trust and a new spirit of partnership.

Military reform

Although Russian forces prevailed easily in Georgia, technological and other weaknesses were shown up by the modernised Georgian military. Deficiencies were exposed in command and control, equipment, training and recruitment. Russia was fighting with old weapons, with conscripts and with limited flexibility and mobility. On 2 October 2008, plans were announced for a major restructuring, reduction and modernisation of the armed forces. Changes included a move from the division to the brigade as the main operational unit, a large reduction in the number of officers, speeding up recruitment of professional (contract) soldiers, revamping the entire system of military education and training, introduction of professional non-commissioned officers, and undertaking large-scale modernisation and re-equipment of the armed forces.

The reform plans ran into fierce resistance. Many military officers believed that such fundamental changes to an already fragile system, which had suffered years of neglect, could fatally damage the institution. Secondly, powerful political and security figures argued that the new armed forces would be unable to fight a large-scale war with NATO, which they continued to see as the main threat to Russia. Bolstering this view, a new National Security Strategy approved by Medvedev in May 2009 clearly stated that Russia anticipated growing tensions between major powers over access to energy resources in regions such as the Arctic and Central Asia. It focused on threats posed by the movement of NATO infrastructure closer to Russia's borders and NATO's orientation towards global threats; pointed out that US–Russian relations still played a key role for the international system as a whole; and reaffirmed Russia's commitment to maintaining strategic nuclear parity with the United States. Among key military threats, the document identified 'policies of some developed states directed at establishing military superiority, first of all in strategic nuclear weapons, precision, informational and other high-tech weapons, strategic conventional weapons, and unilateral steps for deploying missile defence'.

When the plans were unveiled, the Russian leadership was still hoping the global financial crisis would not impact Russia. A significant increase in funding for reorganisation and modernisation was promised. But in the first half of 2009 the budget deficit prompted cuts in defence spending, and the defence industry was badly hit as reduced access to credit disrupted the practice of partial pre-payment for domestic orders. In 2009 the Sukhoi aerospace firm declared it was running at a loss. A number of defence plants were on the brink of closure.

Russia's foreign-policy ambitions, however, required greater use of the military. Partly in response to US military cooperation with Georgia and Ukraine, in 2008–09 the Russian navy made friendly calls on Cuba and Venezuela. Russia sent ships to fight piracy in the Gulf of Aden and the army staged large-scale military exercises in the Caucasus (including Abkhazia and South Ossetia) and with the SCO in Central Asia. Russia also pushed its allies in the Collective Security Treaty Organisation (CSTO) to establish a new operational reaction force. Envisioned as a standing force to deal with threats in Central Asia and other parts of Eurasia, this would rely heavily on the Russian military. Previous CSTO initiatives to set up joint forces had failed, and the capacity of the organisation to implement it with just a handful of disparate states with drastically different military capabilities was in question. Belarus and Uzbekistan did not join the initiative.

The past year provided reminders that long-standing threats to Russian security remained extant. On 16 April 2009 Medvedev issued a decree officially ending the counter-terrorist operation in Chechnya, marking the end of a ten-year conflict that cost tens of thousands of lives. Russia was expected to begin withdrawing its 25,000 troops, all limitations on travel to Chechnya were to be removed, and Grozny airport was set to open for international flights. The end of the Second Chechen War in 2000, with Chechnya still firmly under Russian sovereignty, had helped Putin rise to and consolidate power. But as Medvedev ended the subsequent counter-terrorism effort, there were growing concerns over security and stability in the North Caucasus as a whole. In the first half of 2009 over 300 violent incidents took place across the North Caucasus. Their targets were mostly government and law-enforcement officials. In May the interior minister of Dagestan was shot dead, and on 22 June the president of Ingushetia, Yunus-Bek Yevkurov, was critically wounded in a suicide-bomb attack.

Russia and Ukraine

Further damage to Russia–Western relations in 2008–09 was caused by the January 2009 dispute between Russia and Ukraine which led to the interruption of natural-gas supplies to many of Russia’s EU customers. The EU depends on Russia for just over a quarter of the gas it consumes – some 130bn cubic metres out of 501.4bn in 2007. Just over three-quarters of this gas is transported via pipeline through Ukraine, another 20% through Belarus and the remainder direct to Finland. Some smaller central and southeast European countries are entirely or overwhelmingly dependent on Russian gas supplied via Ukraine. European gas consumption is projected to grow and to rely increasingly on imports, which will amount to 84% of the total by 2030, according to the European Commission. The dispute brought into question Russia’s reliability as a supplier and Ukraine’s as a transit route.

While an earlier disruption of gas supplies in 2006 took many by surprise, there was plenty of warning leading up to the events of January 2009. In February 2008, Russia’s state-controlled energy giant Gazprom announced it was owed more than \$1.5bn in unpaid bills by its Ukrainian counterpart, Naftohaz Ukrainy. In March, Turkmenistan, the major gas supplier to Ukraine via Russia, announced it wanted to raise its export prices significantly from the start of 2009, to levels that Ukraine could not afford.

Thanks to its historical ties to Russia during the Soviet era, Ukraine had paid below-market prices for its gas for years. In October 2008, Putin and Ukrainian Prime Minister Yulia Tymoshenko signed a memorandum envisioning the gradual increase of gas prices from \$179 per thousand cubic metres (tcm) to European ‘market prices’ by 2011. They also agreed that Gazprom and Naftohaz should trade directly, rather than via RosUkrEnerg, a Swiss-registered joint venture between Gazprom and two Ukrainian businessmen. In November, other outstanding amounts owed by Naftohaz to Gazprom surfaced, coupled with fines for late payment. Ukrainian President Victor Yushchenko – long locked in a destabilising power struggle with his former ally Tymoshenko – made reassuring noises but took no practical steps to support the Putin–Tymoshenko memorandum.

When price negotiations for 2009 began in November, Gazprom initially offered to sell gas at \$250 per tcm. Ukraine responded with a counter-bid of \$201, so long as the transit fees that Russia paid for moving its gas across Ukraine – also well below the market rate for historical reasons – were increased from \$1.70 to \$2 per tcm per 100 kilometres. On 30 December, as tensions escalated, Gazprom CEO Alexei Miller withdrew the rejected

\$250 offer and announced that Gazprom would deliver gas to Ukraine from January at what he said was the European market rate of \$418 per tcm. Naftohaz CEO Oleh Dubyna countered with an offer of \$235, together with a \$1.80 per 100km transit fee.

On 31 December, eleventh-hour talks failed to produce agreement, even after Naftohaz said it had paid its arrears for supplies delivered in November and December. On 1 January 2009, Gazprom cut all gas supplies destined for Ukrainian use, but said it was pumping additional volumes to ensure gas reached its European customers. Naftohaz claimed it had several months' gas in storage and that European gas in transit via Ukrainian territory continued to flow normally. The crisis began to have a real impact on Europe on 7 January, when Russia halted all supplies, alleging that Ukraine was stealing gas intended for other customers. Ukraine denied this, saying Russia was not sending enough 'technical gas' to drive the compressors pumping gas towards Europe and to keep the pipes sufficiently pressurised. By 8 January, industrial plants were being forced to slow or stop production, particularly in southeast Europe.

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At this point, the EU felt bound to take action. By 11 January, with both Russian and Ukrainian agreement, teams of EU monitors were deployed at gas-transit sites in both countries. On 16 January, the EU stepped up political pressure: German Chancellor Angela Merkel met Putin and warned that Russia was losing credibility as a gas supplier, while European Commission President José Manuel Barroso warned of 'significant financial, economic and political consequences' for both countries if they did not resolve the dispute. Finally, on 19 January, the Russian and Ukrainian prime ministers signed an agreement under which Ukraine would pay 80% of the 'market price' – the exact figure was not disclosed – for gas imports in 2009, before rising to the full fee in 2010. In exchange, Naftohaz would hold its transit fee for Gazprom unchanged at \$1.70. On 20 January, Russia resumed gas flows.

The gas dispute showed a need for the EU to concentrate on diversification and to help improve the capacity of Ukraine's pipeline system. In May 2009 the Czech presidency of the EU hosted an energy summit in Prague that brought together leaders from Azerbaijan, Egypt, Georgia, Iraq, Kazakhstan, Turkey, Turkmenistan and Uzbekistan to discuss the Southern Corridor, the

planned energy-supply route from the Caspian. Its most important component was to be the Nabucco gas pipeline, envisioned as a means to lessen dependency on Russian gas by bringing Caspian and Iraqi gas to Europe via Turkey. However, the major potential supplier, Turkmenistan, did not sign the summit declaration, and there were still issues regarding the charges Turkey could collect for transit of gas across its territory. Frustrated with slow progress on Nabucco and insufficient support from the EU, Azerbaijani President Ilkham Aliev announced in Moscow in June that some Azeri gas previously reserved for Nabucco would be sold to Gazprom, although the volume of 0.5bcm constitutes only a fraction of Azeri gas production. At the same time, Turkmenistan signed a 30-year deal with China to supply gas via a pipeline scheduled for completion in December 2009, further reducing the prospects for trans-Caspian gas supplies to Europe. The best hope for the Nabucco consortium was northern Iraq. Without supplies from Turkmenistan, however, the pipeline would still provide only a small percentage of Europe's needs and would not dent Gazprom's dominance of the EU gas market.

The EU's efforts to help modernise Ukraine's pipeline system were equally tentative. In March 2009 Ukraine signed an agreement with the EU on modernising its gas-transportation system at an estimated cost of \$3.4bn. The Russian delegation, including Energy Minister Sergei Shmatko, walked out of the meeting in protest at the exclusion from the deal of Russia, the main supplier of gas through Ukraine. Putin criticised it on the same grounds. Ukrainian leaders, including Yushchenko, backtracked and invited Russia to join the project. Moscow was, however, unlikely to participate in an initiative which did not offer the prospect of acquiring some degree of control or ownership of the Ukrainian pipelines, which Kiev insisted would remain in the hands of the state.

Ukraine's economic woes – the collapse in global demand, especially for steel, forced it to agree a rescue loan package with the International Monetary Fund – made it difficult to meet the terms of the January agreement with Gazprom, whereby payment for gas would be made on a monthly basis. Gazprom warned that it would not continue to supply Ukraine if payment was not received. Tensions between Russia and Ukraine were likely to heighten further as January presidential elections approached, in which Yushchenko was expected to lose to one of his long-standing political rivals – Tymoshenko or Victor Yanukovich, head of the formerly pro-Russian Party of Regions.

Reality check

The global economic crisis provided Russia with a serious reality check on its domestic, regional and global ambitions, which had grown during years of economic growth driven by oil and gas revenues. The Russian political system showed itself poorly adapted to dealing with the crisis. Internationally the strategic impact for Russia of its August 2008 war with Georgia was muted by the economic crisis and the change of US administration. However, relations with NATO and the EU looked to remain difficult for Moscow. Obama's initiative to reset US–Russian relations could open a window to strengthening cooperation on arms control, non-proliferation and Afghanistan. However, as the July summit demonstrated, the two sides still had a long way to go to rebuild the trust damaged by the legacy of the Bush era. Russia's own growing security challenges in the North Caucasus, difficulties in implementing defence modernisation and reform and limited resources for foreign-policy adventures could limit Moscow's appetite to continue with unilateral assertiveness and might lead it to seek a new accommodation with the United States and Europe.